

Message Text

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ACTION FS-01

INFO OCT-01 EUR-06 ADP-00 DODE-00 TRSE-00 EB-11 ABF-01

OPR-02 M-03 A-01 /026 W

----- 053277

R 100730Z AUG 73

FM AMEMBASSY ROME

TO SECSTATE WASHDC 220

USCINCEUR VAIHINGEN

INFO AMEMBASSY BONN

AMCONSUL FLORENCE

AMCONSUL GENOA

AMCONSUL MILAN

AMCONSUL NAPLES

AMCONSUL PALERMO

AMCONSUL TRIESTE

AMCONSUL TURIN

AMEMBASSY PARIS

USMISSION OECD PARIS

40 TAC GP FAF AVIANO

COMSIXTHFLT GAETA

USS HOWARD W GILMORE

CINCUSNAVEUR LONDON ENGLAND

USNMR CINCSOUTH NAPLES

COMFAIRMED NAPLES

COMSERFORSIXTHFLT NAPLES

NAF CAPODICHINO NAPLES

NAVSUPPACT NAPLES

CINCUSAFE RAMSTEIN AB GERMANY

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E.O. 11652: N/A

TAGS: EFIN, MIL, IT

SUBJECT: PROPOSED NEW PROCEDURE FOR PURCHASING LIRE FOR USG
EXPENDITURES AND ACCOMMODATION EXCHANGE IN ITALY

FOR STATE, DEFENSE, TREASURY (PASS FISCAL SERVICE FOR COX),
PARIS RFC FOR LERCHBAUMN, USDOCOSOUTH PASS TO USNMR CINCSOUTH NAPLES

REF: (A) MAAG CCOI ROME MSG CH-7-0064 101630Z MAY 73

(B) CINCUSAREUR MSG 311446Z MAY 73

(C) ROME 4941

1. SUMMARY: AS RESULT OF CREATION OF DUAL EXCHANGE RATE SYSTEM EARLIER THIS YEAR, PROBLEM HAS BEEN CREATED AS TO HOW USG CAN LEGALLY OBTAIN MOST FAVORABLE EXCHANGE RATE FOR USG EXPENDITURES AND ACCOMMODATION EXCHANGE IN ITALY. PRESENT MESSAGE PROPOSES THAT ALL U.S. CIVILIAN AND MILITARY AGENCIES PURCHASE LIRA DIRECTLY FROM BANK OF ITALY BY MEANS OF SELLING U.S. CURRENCY TO BANK FOR LIRE. PROPOSED SYSTEM SEEMS TO BE ONLY LEGAL WAY IN WHICH WE CAN EFFECTIVELY OBTAIN ACCESS TO FINANCIAL LIRA RATE, WHICH HAS PERSISTENTLY BEEN MORE FAVORABLE OF TWO MAJOR LEGAL RATES. WE SEEK APPROVAL AND ASSISTANCE OF ACTION ADDRESSEES FOR ADOPTION OF PROPOSED SYSTEM. END SUMMARY.

2. ITALIAN EXCHANGE RATE SYSTEM. CREATION OF DUAL EXCHANGE MARKET IN ITALY IN JANUARY 1973 WITH FLOATING FINANCIAL LIRA RATE, FOLLOWED BY FLOATING OF COMMERCIAL LIRA RATE IN FEBRUARY, HAS CREATED COMPLEX SYSTEM OF MULTIPLE, FLOATING EXCHANGE RATES. THERE NOW EXIST IN ITALY COMMERCIAL LIRA RATE, FINANCIAL LIRA RATE AND SPECIAL FOREIGN BANKNOTE RATE (WHICH IS VARIATION OF FINANCIAL LIRA RATE). THESE ARE ALL LEGAL RATES, BUT ACCESS TO EACH RATE IS DETERMINED BY EXCHANGE CONTROL REGULATIONS. (IN ADDITION, THERE IS BLACK MARKET RATE.) ACCORDING TO EXISTING EXCHANGE CONTROL REGULATIONS, CENTRAL BANK (BANK OF ITALY) AND OTHER AUTHORIZED FOREIGN EXCHANGE SELLERS CAN ONLY SELL LIRE TO USG AT COMMERCIAL LIRA RATE, WHICH IS RATE APPLICABLE TO LIMITED OFFICIAL USE

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"GOVERNMENT SERVICES." HOWEVER, THERE IS EXCEPTION TO NORMAL RULE IN THAT ANYONE POSSESSING FOREIGN BANKNOTES MAY SELL THEM LEGALLY IN SPECIAL FOREIGN BANKNOTE MARKET, REGARDLESS OF NATURE OF UNDERLYING TRANSACTION. TO DATE, FINANCIAL RATE AND SPECIAL FOREIGN BANKNOTE RATE HAVE NEARLY ALWAYS BEEN HIGHER THAN COMMERCIAL RATE.

3. DURING PERIOD SINCE NEW REGIME WAS CREATED VARIOUS

INTERIM ARRANGEMENTS HAVE HAD TO BE USED BY US MILITARY BASES AND BY EMBASSY AND CONSULATES. RESULT HAS BEEN THAT DIFFERENT RATES PREVAIL IN DIFFERENT LOCALES AND THERE IS NO STABILITY IN RATES FOR ACCOUNTING PURPOSES. AT PRESENT, BANK OF ITALY (BOI) IS PREPARED TO SELL COMMERCIAL LIRE ON A DAILY BASIS TO USG. IN CASE OF EMBASSY AND CONSULATES, STATE DEPARTMENT REGIONAL FINANCE OFFICE (RFC) IN PARIS CANVASSES FOREIGN MARKETS TO DETERMINE IF BETTER LIRA RATE IS AVAILABLE OUTSIDE ITALY. EMBASSY AND CONSULATES THEN USE HIGHER OF THESE TWO RATES. ON OTHER HAND, US MILITARY BASES EITHER USE BANK OF ITALY RATE OR ANY BETTER LEGAL RATE THAT THEY CAN OBTAIN LOCALLY. IN ANY CASE, TO EXTENT THAT LOCAL USG REGULATIONS PERMIT SALE OF US BANKNOTES TO US EMPLOYEES, LATTER HAVE BEEN ABLE TO OBTAIN FAVORABLE FOREIGN BANKNOTE RATE ON INDIVIDUAL BASIS. WE DO NOT CONSIDER THAT PRESENT INTERIM SITUATION IS DESIRABLE AS PERMANENT BASIS FOR OBTAINING LIRE FOR USG EXPENDITURES AND ACCOMMODATION EXCHANGE IN ITALY.

4. PROPOSAL. OBJECTIVES IN MAKING PRESENT PROPOSAL ARE:
(A) TO OBTAIN BEST LEGAL EXCHANGE RATE, (B) TO HAVE UNIFIED RATE FOR ALL MILITARY AND CIVILIAN AGENCIES THROUGHOUT ITALY, AND (C) TO HAVE SOME STABILITY IN EXCHANGE RATE FOR ACCOUNTING PURPOSES. PROPOSED METHOD OF OBTAINING BETTER EXCHANGE RATE IS TO MAKE USE OF SPECIAL FOREIGN BANKNOTE RATE. IF USG AGENCIES WERE TO SELL US BANKNOTES IN FOREIGN BANKNOTE MARKET IN VOLUME REQUIRED TO MEET TOTAL USG LIRE NEEDS, EFFECT WOULD BE TO DEPRESS DOLLAR RATE IN THIS RATHER NARROW MARKET, MAKING RATE UNATTRACTIVE. HOWEVER, WE HAVE NOW OBTAINED APPROVAL FROM BOI OF PROPOSAL WHEREBY BANK, ITSELF, WOULD BUY US BANKNOTES, SO THAT TRANSACTIONS WOULD NOT PASS THROUGH MARKET WITH CORRESPONDING DEPRESSING EFFECT. RATE WHICH WOULD BE USED LIMITED OFFICIAL USE

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IS TEN-DAY AVERAGE OF LARGE DENOMINATION FOREIGN BANKNOTE RATES IN MILAN AND ROME. BOI WOULD BE PREPARED TO SELL LIRE AT THIS RATE FOR FIXED PERIODS OF TEN DAYS. THUS, UNIFORM RATE COULD BE USE BY ALL USG AGENCIES IN ITALY.

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5. US INSTALLATIONS IN ITALY COULD BUY LIRE DIRECTLY FROM
CLOSEST BOI BRANCH AT 10-DAY AVERAGE RATE TO EXTENT
THEY HAVE US BANKNOTES. HOWEVER, BRIEF SURVEY OF US
MILITARY AND CIVILIAN AGENCIES INDICATES THAT US BANKNOTES

WOULD NOT NORMALLY BE AVAILABLE IN QUANTITIES REQUIRED. WE HAVE ALSO CANVASSED CONTROLLERS IN EUROPEAN HEAD-QUARTERS OF THREE MILITARY SERVICES AND RFC IN PARIS AND ARE TOLD THAT US BANKNOTES ARE NOT AVAILABLE IN SUFFICIENT QUANTITIES THERE, EITHER. THEREFORE, IT WOULD BE NECESSARY TO IMPORT US BANKNOTES FROM US IN ORDER TO SUPPLEMENT BANKNOTES AVAILABLE IN ITALY. WE HAVE ALREADY OBTAINED AGREEMENT IN PRINCIPLE FROM BANK OF ITALY AND ITALIAN TREASURY FOR PERIODIC IMPORTATION OF US DOLLAR BANKNOTES. INITIAL SHIPMENT WOULD BE ON ORDER OF \$4-5 MILLION WHICH REPRESENTS ABOUT TWO WEEK'S LIRE REQUIREMENTS FOR ALL US CIVILIAN AND MILITARY INSTALLATIONS IN ITALY. WE WOULD SELL THIS CURRENCY TO BANK FOR LIRE AT FOREIGN BANKNOTE EXCHANGE RATE AND TRANSFER LIRE TO VARIOUS US AGENCIES IN ACCORDANCE WITH THEIR LIRA NEEDS. WE WOULD CONTINUE TO IMPORT ADDITIONAL GREENBACKS ON A PERIODIC BASIS, POSSIBLY EVERY TWO WEEKS OR EVERY MONTH. IF REGULARLY SCHEDULED SHIPMENTS PROVED TOO CUMBERSOME, WE WOULD STILL BE ABLE TO PURCHASE LIRE AT COMMERCIAL RATE WITH DOLLAR CHECKS WHEN US BANKNOTES WERE NOT AVAILABLE IN SUFFICIENT QUANTITY. IN EFFECT, BOTH SYSTEMS COULD FUNCTION TOGETHER. EVEN PARTIAL USE OF BANKNOTE RATE WOULD PERMIT US TO OBTAIN A MORE FAVORABLE RATE THAN IF WE HAD ACCESS TO COMMERCIAL RATE ALONE.

6. FOR CONVENIENCE, IT WOULD BE DESIRABLE TO DESIGNATE ONE MILITARY DISBURSING OFFICER: HE WOULD: (1) TAKE PERIODIC ORDERS FOR LIRA PURCHASES NEEDED BY EACH US INSTALLATION, (2) MAKE LIRA PURCHASES FROM BOI WITH US BANKNOTES STOCKPILE, (3) ACCEPT PAYMENT FROM THESE USG AGENCIES TO REIMBURSE OF US BANKNOTES, AND (4) ARRANGE FOR TRANSFER OF LIRA PROCEEDS TO USG AGENCIES PLACING ORDER.

7. WE RECOGNIZE THAT NEED TO PERIODICALLY IMPORT US BANKNOTES WOULD BE RATHER CUMBERSOME, BUT BELIEVE THAT LIMITED OFFICIAL USE

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BETTER EXCHANGE RATE WOULD WARRANT EXTRA EFFORT REQUIRED. FOR EXAMPLE, IN PERIOD MARCH 20 THROUGH AUGUST 8 AVERAGE COMMERCIAL LIRA RATE WAS 586 LIRE PER DOLLAR; AVERAGE REGULAR FINANCIAL LIRA RATE WAS 603; AND AVERAGE FOREIGN BANKNOTE RATE WAS 602. (ONLY ON ONE DAY DURING THIS PERIOD DID COMMERCIAL RATE EXCEED BANKNOTE RATE AND SPREAD IN FAVOR OF BANKNOTE RATE HAS AVERAGED 29 LIRE PER DOLLAR DURING LAST TEN DAYS.) BANK OF ITALY DATA FOR 1972 SHOW TOTAL USG CONVERSIONS OF DOLLARS INTO LIRA UNDER 1947 TASCA AGREEMENT AMOUNTED TO ALMOST \$90 MILLION. THUS, ADDITIONAL 16 LIRA PER DOLLAR WHICH COULD HAVE BEEN OBTAINED UNDER BANKNOTE RATE (RATHER THAN NORMALLY

APPLICABLE COMMERCIAL RATE) WOULD REPRESENT ANNUAL SAVINGS OF ABOUT \$2.5 MILLION ON TOTAL USG PURCHASES OF LIRE.

8. ADMITTEDLY, WE CANNOT BE CERTAIN THAT FAVORABLE SPREAD BETWEEN BANKNOTE RATE AND COMMERCIAL RATE WILL CONTINUE INDEFINITELY, NOR EVEN THAT DUAL MARKET WILL NTO EVENTUALLY BE ABOLISHED AND RATES UNIFIED. HOWEVER, SHOULD COMMERCIAL LIRA RATE EXCEED BANKNOTE RATE, THERE WOULD BE NO LEGAL PROBLEM UNDER ITALIAN EXCHANGE CONTROL LAW IF USG WERE TO PURCHASE LIRE WITH DOLLAR CHECK AT COMMERCIAL RATE EITHER IN ITALY OR OUTSIDE ITALY. EXPERIENCE BY STATE DEPARTMENT REGIONAL FINANCE OFFICE (RFC) IN PARIS DURING RECENT MONTHS IN SHOPPING AROUND OUTSIDE ITALY FOR MORE FAVORABLE RATE INDICATES THAT RATE OBTAINABLE IS ONLY OCCASIONALLY A FEW LIRE MORE FAVORABLE THAN COMMERCIAL RATE IN ITALY. RATE HAS BEEN MORE FAVORABLE THAN BANKNOTE RATE IN ITALY ON ONLY ONE OCCASION SINCE MARCH 20. FINALLY TO EXTENT LOCAL USG REGULATIONS PERMIT, IT WOULD STILL BE POSSIBLE FOR INDIVIDUALS TO OBTAIN DOLLAR CURRENCY AND PURCHASE LIRE AT DAILY BANKNOTE RATE FROM COMMERCIAL BANK OR EXCHANGE DEALER WHENEVER AVERAGE BANKNOTE RATE DIVERGED FROM DAILY BANKNOTE RATE. HOWEVER, SUCH DIVERGENCE SHOULD BE FAIRLY MODEST.

9. WE RECOGNIZE THAT PHYSICALLY SHIPPING US CURRENCY FROM US WOULD RESULT IN SOME FOREGONE INTEREST INCOME. IN ADDITION, US WILL ALSO HAVE TO BEAR COSTS CONNECTED WITH SHIPMENT OF BANKNOTES BY BOI BACK TO US FOR DEPOSIT TO BOI'S ACCOUNT WITH FRB NEW YORK. BOI HAS PROPOSED THAT BETWEEN .15 - .2 PERCENT BE DEDUCTED FROM LIMITED OFFICIAL USE

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BANKNOTE RATE TO PAY FOR SHIPMENT AND INSURANCE CHARGES. THESE FACTORS WOULD HAVE TO WEIGH AGAINST THE GAINS FROM A HIGHER EXCHANGE RATE.

10. FOR RECIPIENTS OF REFTELS: NOTE THAT ABOVE PROPOSAL SUPERCEDES EARLIER PROPOSAL FOR CENTRALIZED PURCHASES OF LIRE AT COMMERCIAL LIRA EXCHANGE RATE THROUGH RFC IN PARIS (REF A). WE STILL INTEND THAT TASCA AGREEMENT WOULD REMAIN IN EFFECT, MODIFIED BY EXCHANGE OF LETTERS WITH BOI. BANKNOTE PROPOSAL, IN FACT, REPRESENTS RELATIVELY LITTLE CHANGE IN PROCEDURES FROM THOSE USED FOR MANY YEARS UNDER TASCA AGREEMENT. FOR EXAMPLE, LIRA PURCHASES WOULD CONTINUE TO BE MADE DIRECTLY FROM BOI AT AVERAGE EXCHANGE RATE FOR PREVIOUS PERIOD. ON OTHER HAND, PARTIAL CENTRALIZATION OF LIRA PURCHASES WOULD REPRESENT SLIGHT VARIATION FROM OLD TOSCA AGREEMENT PRACTICES.

11. ACTION REQUESTED: BANKNOTE RATE PROPOSAL HAS BEEN INFORMALLY DISCUSSED WITH FINANCE OFFICERS OF MAJOR US

MILITARY BASES IN ITALY AND HAS SUPPORT OF BOTH CIVILIAN AND MILITARY COMPONENTS OF US MISSION ROME. WE WOULD WELCOME COMMENTS OF RECIPIENTS, IF THEY FORESEE ANY SERIOUS PROBLEMS WITH PROPOSAL. IF CINCEUR CONCURS, RECOMMEND IT DESIGNATE MILITARY AGENCY IN ITALY ACT AS CENTRAL DISBURSING OFFICER PER PARAGRAPH 6 ABOVE. IF PROPOSAL WERE ADOPTED, WE WOULD EXPECT IT TO OVERRIDE ANY CONFLICTING CIVILIAN OR MILITARY REGULATIONS, AS WAS THE CASE UNDER TASCA AGREEMENT. IN PARTICULAR, WE UNDERSTAND THAT STATE DEPARTMENT DISBURSING OFFICERS ARE NORMALLY BOUND BY SECTION 331.3 OF DEPARTMENT OF STATE MANUAL (4FAM), WHICH REQUIRES USE OF DAILY RATE OF EXCHANGE. THIS REGULATION WOULD NOT BE COMPATIBLE WITH OUR PROPOSAL AND WAIVER WOULD HAVE TO BE GRANTED IF PROPOSAL WERE ADOPTED.

12. REQUEST APPROVAL OF ACTION ADDRESSES AS SOON AS POSSIBLE, AS WE WOULD LIKE TO BE ABLE TO PUT NEW SYSTEM INTO EFFECT EARLY SEPTEMBER. VOLPE

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Message Attributes

Automatic Decaptioning: X
Capture Date: 01 JAN 1994
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: n/a
Control Number: n/a
Copy: SINGLE
Draft Date: 10 AUG 1973
Decaption Date: 01 JAN 1960
Decaption Note:
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Authority: hilburpw
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 28 MAY 2004
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1973ROME08084
Document Source: CORE
Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: N/A
Errors: N/A
Film Number: n/a
From: ROME
Handling Restrictions: n/a
Image Path:
ISecure: 1
Legacy Key: link1973/newtext/t19730845/aaaabgwe.tel
Line Count: 349
Locator: TEXT ON-LINE
Office: ACTION FS
Original Classification: LIMITED OFFICIAL USE
Original Handling Restrictions: n/a
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 7
Previous Channel Indicators:
Previous Classification: LIMITED OFFICIAL USE
Previous Handling Restrictions: n/a
Reference: (A) MAAG CCOI ROME MSG CH-7-0064 101, 630Z MAY 73
Review Action: RELEASED, APPROVED
Review Authority: hilburpw
Review Comment: n/a
Review Content Flags:
Review Date: 10 SEP 2001
Review Event:
Review Exemptions: n/a
Review History: RELEASED <10-Sep-2001 by hilburpw>; APPROVED <19-Sep-2001 by hilburpw>
Review Markings:

Declassified/Released
US Department of State
EO Systematic Review
30 JUN 2005

Review Media Identifier:
Review Referrals: n/a
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
Secure: OPEN
Status: NATIVE
Subject: PROPOSED NEW PROCEDURE FOR PURCHASING LIRE FOR USG EXPENDITURES AND ACCOMMODATION EXCHANGE IN ITALY
TAGS: EFIN, MILI, IT
To: STATE
Type: TE
Markings: Declassified/Released US Department of State EO Systematic Review 30 JUN 2005